

# CRS Report for Congress

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## Ecuador: Political and Economic Situation and U.S. Relations

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### Summary

In January 2003, Lucio Gutierrez of the Patriotic Society Party (PSP), a former army Colonel who was part of the junta that toppled the government of Jamil Mahuad in January 2000, became the country's sixth president in seven years. Early in his presidency, President Gutierrez abandoned his populist rhetoric and adopted some market-friendly economic reforms in order to secure support from the International Monetary Fund (IMF). His power was severely limited, however, by opposition parties that dominated the Congress, indigenous protests, and allegations of corruption. Despite his party's poor performance in the October 17, 2004 municipal elections, President Gutierrez has found new congressional allies who have helped him stave off impeachment proceedings and place many political allies on the country's high courts. Ecuador continues to cooperate with the U.S. counter-narcotics program and has mobilized its military and police forces to help control spillover effects from the conflict in Colombia. Ecuador and the United States possess a significant trade relationship that has been enhanced since 1992 by the Andean Trade Preference Act. The two countries are currently negotiating, along with Colombia and Peru, for an Andean Free Trade Agreement. This report will be updated periodically.

### Background

Slightly smaller than Nevada, Ecuador has a population of just under 13 million people. Since independence from Spain in 1830, Ecuador lost 61% of its total land area as a result of border conflicts with Brazil, Colombia and Peru. Despite its small size, Ecuador's location on the Pacific Coast between Colombia and Peru, two major drug producing countries, makes it of strategic importance to the United States. Ecuador is the 15<sup>th</sup> largest oil supplier to the United States, and the 4<sup>th</sup> largest supplier (behind Mexico, Venezuela, and Colombia) in Latin America. Ecuador is both geographically and ethnically diverse, and has a relatively long experience with democratic rule. The population is ethnically mixed: 55% mestizo (mixed Indian and Spanish descent), 25% indigenous, 10% Caucasian, and 10% African. Some 56% of the population and more

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than 80% of indigenous Ecuadorians live in poverty.<sup>1</sup> Although Ecuador returned to civilian rule in 1979, the political and economic situation there has often been unstable. Political stability in Ecuador is threatened by such forces as poverty, corruption, and political fragmentation, in addition to the difficulty of balancing between popular demands and fiscal reforms.

## Political Context

Ecuador was once considered a relatively stable country located in the conflicted Andean region. In recent years, however, Ecuador has weathered a number of serious governmental and economic crises. The last two popularly elected presidents did not complete their terms. Abdala Bucaram was removed from office constitutionally in 1997, after being declared mentally unfit by the National Congress and allegedly misappropriating \$90 million worth of public funds. Jamil Mahuad was ousted by a coup in 2000 after a prolonged economic crisis. The current President, Lucio Gutierrez, inaugurated on January 15, 2003 to a four-year term of office, was an unknown army Colonel until his involvement in the 2000 coup that ousted Mahuad. President Gutierrez, elected with 55% of the vote on a leftist platform, with the support of poor and indigenous voters, is now confronting a political crisis of his own. His PSP party lost the support of the Pachakutik indigenous party in August 2003, and holds only 6 seats in the 100-member Congress. In October 2004, Gutierrez's approval rating hovered at just 15%, his party performed poorly in the municipal elections, and he was facing possible impeachment proceedings.<sup>2</sup> By November 2004, Gutierrez had formed a new coalition with support from Bucaram's Roldosista Party (PRE) and Alvaro Noboa's National Action Institutional Renewal Party (PRIAN). He has been under criticism recently for using his legislative coalition to pack Ecuador's courts with his political allies.<sup>3</sup>

There are historical antecedents for the instability that has recently plagued Ecuadorian democracy. Since 1830, regionalism and personalism have defined Ecuadorian political culture. Throughout the country's history, Quito, the colonial capital, and Guayaquil, the industrial port, have battled for urban dominance. Superimposed against this regional divide are the ethnic and class divisions that have encouraged political parties to develop as electoral machines for competing segments of the elite. Following the return to democracy in 1979, party splits, bureaucratic ineptitude and rampant corruption proliferated. Important reform measures — civil service reform, tax laws, banking regulation — stalled in a Congress dominated by fragmented parties and vocal opponents with vested interests to protect. As the economic situation has deteriorated since the 1980s, voters have reacted by blaming incumbents for their troubles and by periodically backing populist, anti-party candidates. This trend, coupled with the country's economic problems and rampant corruption, has led to inconsistent economic

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<sup>1</sup> "Ecuador: Indigenous Groups Break with President," *NACLA Report on the Americas*, New York: Mar/Apr 2003; Suhas Parendeka, Rob Vox, and Donald Winkler, "Ecuador: Crisis, Poverty and Social Protection," in *Crisis and Dollarization in Ecuador: Stability, Growth and Social Equity*, Paul Beckerman and Andrés Solimano, eds., Washington: The World Bank.

<sup>2</sup> "Ecuador's Congress May Pursue Gutierrez's Impeachment," *Dow Jones International News*, October 25, 2004.

<sup>3</sup> Michael Shifter, "President Makes Mockery of Rule of Law," *Miami Herald*, January 3, 2005.

and political policies from one administration to the next, and to the inability of elected presidents to complete their terms. Ecuador has had six presidents in the past seven years.

Ecuador's dependence on oil exports and remittances (cash transfers sent from citizens living abroad), vulnerability to natural disasters, high levels of foreign debt, and central location within the volatile Andean region have made it extremely vulnerable to exogenous shocks. The country's inefficient policy-making process, a system in which a plethora of competing economic and political interests compete for political spoils, has tended to delay or inhibit the success of policy initiatives and failed to shield the country from external shocks.<sup>4</sup> Two examples of this tendency have included the Ecuadorian Congress' rejection of a proposed hydrocarbon reform bill, intended to increase private investment in the under-performing state-owned oil sector, and its decision to override a presidential veto in order to enact pension increases. Both of these congressional actions violated IMF fiscal recommendations.<sup>5</sup>

**Role of the Indigenous.** Ecuador's indigenous population resides primarily in the country's highland and Amazonian regions. Indigenous peoples have historically been among the most disadvantaged, under-represented groups in Ecuador. Since the indigenous people began organizing politically in 1990, however, they have built two of the most powerful indigenous organizations in Latin America: the Confederation of Indigenous Nationalities of Ecuador (CONAIE) and the Pachakutik political party. While Pachakutik currently holds 10% of the seats in the Congress, indigenous groups have gained more notoriety for their mass protests than for their electoral successes. The participation of Pachakutik in the Gutierrez government, which included two cabinet appointments, marked the first time in the country's history that an indigenous-based political party participated in a governing coalition. Some observers argue that the short-lived duration of that coalition has weakened the movement's popularity, noting the declining attendance at recent indigenous protests.<sup>6</sup> Although the indigenous movement is currently divided and may not pose a threat to the Gutierrez government, some indigenous groups have stepped up protests against foreign oil companies on behalf of environmental and economic objectives.<sup>7</sup>

**Corruption.** According to Transparency International, Ecuador is perceived as the second most corrupt nation in Latin America after Paraguay, with a level of corruption rivaling that of the Democratic Republic of the Congo, Iraq, Sierra Leone and Uganda. In 2003, a series of arms trafficking scandals threatened to undermine the generally positive reputation of one of the country's most respected political institutions, the Ecuadorian military.<sup>8</sup> During the campaign, President Gutierrez promised to fight governmental corruption, but has thus far been criticized for nepotism and failing to

<sup>4</sup> Mejia-Acosta, Andres, Caridid Araujo, Anibal Perez Linan, Sebastian M. Saiegh, and Simon Pachano. "Political Institutions, Policymaking Processes, and Policy Outcomes in Ecuador," FLACSO-Inter-American Development Bank, August 2004.

<sup>5</sup> "IMF: Ecuador Must Reform Economy to Become More Competitive," *Dow Jones*, August 12, 2004.

<sup>6</sup> "Pachakutik Support on the Wane," *Latin American Regional Report*, August 3, 2004.

<sup>7</sup> "Ecuador Risk: Risk Overview," *Economist Intelligence Unit*, December 20, 2004.

<sup>8</sup> "Arms Scandal Seen Hurting Ecuador Military's Image," *Reuters*, October 25, 2003.

secure the extradition of corrupt Ecuadorian bankers residing in the United States. Ecuador's Congress is investigating ongoing allegations that drug traffickers contributed to the Gutierrez presidential campaign.<sup>9</sup>

**Human Rights.** The State Department Human Rights report on Ecuador covering 2003 states that "the Government generally respected the human rights of its citizens; however, there were problems in some areas." The report cited 11 killings by security forces in 2003, down from 23 in 2002. Despite progress in reducing the number of extrajudicial killings and the use of unwanted legal force, many perpetrators continue to go unpunished as a result of lax sentencing in police and military courts. Although the Constitution prohibits trafficking in persons, there are no penal laws to enforce that prohibition. In June 2004, the U.S. State Department placed Ecuador on the Tier 3 list of countries not taking adequate measures to combat trafficking in persons. Ecuador was able to avoid U.S. sanctions, however, by taking significant counter-trafficking actions by September 2004.<sup>10</sup>

## Economic Situation

In 1999-2000, Ecuador suffered a disastrous economic crisis, the country's worst in more than seventy years, characterized by numerous bank failures, hyperinflation, double-digit unemployment and an eventual currency collapse. The Ecuadorian financial crisis revealed the deleterious effects that external shocks can have on a weak and poorly regulated economy that is overly dependent on a few export commodities with volatile prices. From 1993-1997, Ecuador's three major exports — oil, shrimp, and bananas — experienced an unprecedented boom. In 1998, El Niño rains caused an estimated \$2.6 billion worth of crop damage, white spot disease hit the shrimp industry, and oil prices plunged. These problems were exacerbated by the scarcity of credit available following the East Asian, Russian and Brazilian financial crises. Massive exchange rate depreciation and declining GDP meant that the government could no longer afford to bail out private investors or failing banks incapable of repaying their dollar-denominated debts. By late 1999, the public debt to GDP ratio was over 100% and the Mahuad administration was faced with a full-scale economic, political and social crisis.<sup>11</sup>

In a last ditch effort to stop hyperinflation and prevent a complete currency collapse, then-president Mahuad abandoned the country's domestic currency in favor of the U.S. dollar. Dollarization was also a calculated political maneuver, though ultimately unsuccessful, to preserve the Mahuad administration. Mahuad's successor, Gustavo Noboa, followed through on the dollarization plan. As a result, inflation subsided and, boosted by high oil prices, the economy grew by 5.1% in 2001 and 3.4% in 2002. The Noboa government then created a stabilization fund using excess oil revenue and improved the country's tax system. However, rather than agreeing to a renewal of a stand-by agreement with the IMF, which would have required privatizing the electricity

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<sup>9</sup> "Failure of 'Uprising' Extends Respite for Gutierrez," *Latin American Weekly Report*, June 15, 2004.

<sup>10</sup> "Four Nations Move Against Trafficking in Response to U.S. Report," [<http://www.usinfo.state.gov>].

<sup>11</sup> Beckerman and Solimano, *Crisis and Dollarization in Ecuador*, The World Bank, 2002.

and telecommunications industries, Noboa responded to popular demands for increased government spending.

President Gutierrez began his administration by appointing a pro-market finance minister who was able to help him secure the \$205 million IMF stand-by agreement that had eluded the Noboa administration. In order to comply with IMF requirements, the Gutierrez government attempted to restrict public spending, increase taxes, remove subsidies, and promote private investment in the oil sector. These efforts spawned sustained popular protests that culminated in the resignation of Mauricio Pozo, the economy minister, in June 2004. Although the economy grew some 6.3% in 2004 as a result of high oil prices and a weak U.S. dollar, which has made its exports more competitive, a lack of fiscal discipline has postponed the renewal of a new (and much needed) IMF stand-by agreement. Ecuador's sovereign bonds have been identified as the riskiest investment in Latin America.<sup>12</sup>

## Relations with the United States

Ecuador's relations with the United States are generally good, although the limited U.S. assistance Ecuador has received in comparison to other Andean nations has been a contentious issue. Ecuador is located at the epicenter of the most conflicted region in the Western Hemisphere, and cooperates with the United States in the containment of Colombian guerrillas and the fight against illicit narcotics. The U.S. government is concerned about Ecuador's high level of corruption, endemic poverty, weak political system, and burdensome foreign debt. Ecuador is also the largest source of illegal immigrants to the United States in South America. In addition to the problem of illegal migration, some of which is caused by alien smuggling, the International Labor Organization estimates that some 5,200 Ecuadorian children are internally trafficked for prostitution.<sup>13</sup> Ecuador was placed on the State Department's 2004 Tier 3 List of countries that had not adequately combated trafficking in persons, but avoided U.S. sanctions by making progress on that issue between June and September 2004. The Bush Administration is currently negotiating an Andean Free Trade Agreement with Ecuador, along with Colombia, and Peru.

**Counter-narcotics Cooperation.** Ecuador, a major transport country for cocaine and heroin, has worked closely with the United States in its counter-narcotics efforts. In November 1999, the United States signed a 10-year agreement with Ecuador for the creation of a forward operating location (FOL) at Manta, an air force base along the Pacific Coast. Since that time, U.S. detection and monitoring operations have seized more than 250 tons of cocaine. Ecuador received an estimated \$35 million in U.S. assistance for FY2004 and \$26 million has been requested in FY2005 for law enforcement, border security, and alternative development as part of the Andean Counterdrug Initiative (ACI).<sup>14</sup>

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<sup>12</sup> "Long-term Bets on Ecuador Seen Hinging on Reforms," *Reuters News*, September 1, 2004.

<sup>13</sup> U.S. Department of State, *Country Reports on Human Rights Practices 2003: Ecuador*, February 2004.

<sup>14</sup> See CRS Report RL32337, *Andean Counterdrug Initiative (ACI) and Related Funding Programs: FY2005 Assistance*, by Connie Veillette.

**U.S. Aid.** The United States is the largest bilateral donor in Ecuador, allocating an estimated \$42 million in total assistance to Ecuador in FY2004. The Administration has requested \$52 million in assistance to Ecuador for FY2005. Four USAID goals for Ecuador are bolstering democracy, poverty reduction, environmental protection, and border security. On July 1, 2003, the Bush administration cut off certain forms of military aid to Ecuador for not signing an agreement exempting U.S. service members from the jurisdiction of the International Criminal Court. This decision cost the Ecuadorian government \$7.6 million in military assistance for FY2004. It may also result in the loss of \$13 million in Economic Support Funds and \$7.6 million in military aid in FY2005.

**Trade.** The United States is Ecuador's main trading partner. The United States exported \$1.3 billion in goods to Ecuador in 2003, with machinery and paper products the leading items. In the same year, the United States imported \$2.7 billion in Ecuadorian goods, primarily oil, bananas, and shrimp. Petroecuador, the state-owned oil company, accounts for 55% of the country's oil production and is not slated for privatization. In total, approximately 45% of Ecuadorian exports go to the United States. Since joining the World Trade Organization (WTO) in 1996, Ecuador has lowered its average tariff rate from 30% to 13%, but a number of non-tariff trade barriers, such as denying import permits and tough sanitary controls, impede U.S. access to the Ecuadorian market.

Since 1992, Ecuador has been a beneficiary of the Andean Trade Preference Act (ATPA). Although petroleum continues to dominate its export market, other goods, such as seafood and cut flowers, have benefitted from the program. The ATPA was reauthorized and expanded to become the Andean Trade Promotion and Drug Eradication Act (ATPDEA), Title XXXI of the Trade Act of 2002, signed into law by President Bush on August 6, 2002 (P.L. 107-210, H.R. 3009). The law extended the preferential trade program until December 31, 2006, and expanded it to include several additional categories of exports of importance to Ecuador, such as certain textiles, petroleum, and pouched tuna. Six rounds of negotiations for a new free trade agreement (FTA) between Ecuador, Colombia, Peru and the United States have been held since May 2004. In October 2004, the Subcommittee on the Western Hemisphere of the House International Relations Committee held a hearing on unresolved trade disputes involving U.S. companies and the governments of Ecuador and Peru that could threaten support for the Andean FTA.

In December 2004, Regina Vargo, chief negotiator of the Andean FTA for the United States, asserted that, although the countries failed to reach agreements on certain agricultural items and on intellectual property issues, the sixth round of negotiations was "the most effective of all so far."<sup>15</sup> The seventh round of negotiations will be held on January 31, 2005, in Colombia, and the eighth round has been set for March 2005. Negotiators hope to conclude an FTA with the Andean nations well before President Bush's current trade promotion authority expires in mid-2005.

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<sup>15</sup> "Colombia, Peru, Ecuador with USA Close Sixth Round of FTA Negotiations," Latin America News Digest, December 6, 2004.